IAS 39: Measurement of an Investment in a Private Company

Extract, IFRS Discussion Group Report on Meeting – January 11, 2013

Paragraph 43 of IAS 39 *Financial Instruments: Recognition and Measurement* generally requires that financial assets be recognized at fair value initially, plus, in the case of a financial asset not at fair value through profit or loss, transaction costs that are directly attributable to the acquisition of the financial asset.

Subsequent measurement of financial assets is generally also at fair value, with certain exceptions as stipulated in paragraph 46 of IAS 39. Generally, equity investments are amongst those carried subsequently at fair value. The exception to this general rule is certain specified investments in unquoted securities as stated in paragraph 46(c) of IAS 39: "investments in equity instruments that do not have a quoted market price in an active market and whose fair value cannot be reliably measured and derivatives that are linked to and must be settled by delivery of such unquoted equity instruments, which shall be measured at cost."

Paragraph 80 of the Application Guidance to IAS 39 elaborates on these requirements and indicates that fair value is considered "reliably measurable if (a) the variability in the range of reasonable fair value estimates is not significant for that instrument or (b) the probabilities of the various estimates within the range can be reasonably assessed and used in estimating fair value."

Additionally, paragraph 81 of the Application Guidance indicates that, in many circumstances, the variability of fair value estimates should not be significant, and that "normally" it is possible to reasonably estimate a fair value for an equity instrument that was acquired from a third party.

The Group considered when cost is acceptable as the ongoing measurement basis for an investment in a private company classified as available for sale.

The Group's Discussion

Group members noted that there should be many cases in which it should be possible to reliably measure fair value of investments in unquoted securities and circumstances when the exception in paragraph 46 of IAS 39 applies should be rare.

Group members observed that it is inappropriate to simply set an accounting policy that all investments in unquoted securities are carried at cost. Instead, further analysis is required to support a conclusion that it is not possible to reliably measure fair value of each investment and that the exception can be applied. Group members noted that entities that initially conclude the exception applies have often not performed a sufficiently rigorous analysis to support that conclusion. Group members observed that entities must continuously reassess whether the exception applies at each reporting date.

Group members noted that IFRS 9 *Financial Instruments*, which is effective for annual periods beginning on or after January 1, 2015, would appear to lessen the ability to measure, subsequent to initial recognition, investments in unquoted securities at cost when compared to IAS 39. IFRS 9 addresses investments in unquoted equity securities in a different manner than IAS 39. IFRS 9 requires fair value but provides that, in some cases, cost may be an appropriate estimate of fair value. In contrast, IAS 39 permits an exception to the use of cost when fair value cannot be reliably measured.

Group members noted that in practice, the exception in IAS 39 has been applied in some limited circumstances and more so in some sectors, such as the junior markets. Group members noted that this issue is generally problematic for these entities and there will be a lot of pressure not to spend a lot of time and money to determine fair value when applying IFRS 9 in those circumstances. Group members observed that this issue is particularly significant for entities in the junior sector, which often issue or receive shares in exchange for goods and services.

In December 2012, the International Accounting Standards Board (IASB) issued educational material regarding IFRS 13 on "Measuring the fair value of unquoted equity instruments within the scope of IFRS 9 Financial Instruments." This material is non-authoritative guidance that accompanies, but is not part of, IFRS 13.